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SUBJECT: AMBASSADOR'S FAREWELL CALL ON CENTRAL BANK GOVERNOR

(U) Classified by Ambassador W. Robert Pearson. Reason:
1.5(b,d)

1. (C) During a July 14 farewell call, Ambassador praised Central Bank Governor Serdengecti for his economic policy work and his cooperation with the U.S., and solicited Serdengecti's views on the issues on which the new Ambassador might want to focus. Serdengecti responded that the most important thing the United States could do was to implement a strong public relations program to counter its poor image in Turkey and the region. He noted that, despite all the good things the U.S. had done to help Muslims and to help Turkey (he noted support for economic reform and EU accession), most people still do not see the U.S. in a positive light. Serdengecti said he was seeing mixed reports on whether bilateral relations were improving. To some extent, a nationalist tone in the Turkish press is to be expected; however, he fears that some in Turkey are portraying the U.S. and the IMF as "no good" to further their aims of keeping Turkey isolated and "third world."

2. (SBU) Serdengecti sees both good and bad economic trends. On the positive side, inflation -- which had not fallen significantly since December -- has begun to decline again. He predicted the lira's strength and falling agricultural prices, combined with the base year effect (i.e. high inflation in the second half of 2002), would enable Turkey to keep CPI below 25 percent and probably close to 20 percent this year, assuming no sharp decline in the lira. Although domestic demand is growing moderately -- hence little risk of economic overheating -- growth overall is "beyond expectations." The fact that growth has yet to generate many jobs means productivity is increasing, which is healthy. Over time, growth will increase support for the reform program. For the moment, the current account deficit is not a cause for alarm, though the Bank is keeping a close eye to see if imports of consumer goods (now at 11 percent of imports) rise to levels indicating domestic demand is becoming excessive.

3. (C) The main negative, per Serdengecti, is that the government is not doing what it needs to do in terms of reforms and meeting IMF conditions. This failure is keeping interest rates high (above 50 percent), and sooner or later will be reflected in the exchange rate. Serdengecti said State Minister Babacan knows the situation better than others, and tells the truth in internal meetings (though he refrains from issuing public warnings); the bigger problem is Finance Minister Unakitan, who "lacks understanding" of the economic situation. Serdengecti said he is not sure if the Prime Minister gets it. After he and the PM last met, the PM changed his rhetoric and started sounding like a Central Bank governor. However, the technocrats see him only occasionally, and others who are close to him regularly give him bad information and advice. As a result, the Governor expects the GOT to continue to move slowly on reforms until the markets react.

4. (SBU) Looking back on the past three years, Serdengecti pointed to two major economic achievements: growth, which has brought GNP back to pre-crisis levels; and an economy that is more resilient in the face of shocks, the result of the shift to a floating exchange rate and numerous structural reforms. Inflation has come down some, but Serdengecti will not feel comfortable until it falls below 20 percent.

5. (C) Serdengecti dismissed the notion -- bandied about during PM Erdogan's recent trip to Malaysia -- that the government would abandon the IMF approach. The main characteristic of this government, he argued, is that it loves "bright ideas" -- jumping on alternative solutions as if no one had ever considered them before. One day the solution is the Malaysian approach, and the next day it is Islamic money coming from the Gulf. The government, he continued, explores these alternatives until they learn --

usually from the press or the bureaucracy -- that they are infeasible. It is, he said, a time-wasting and costly approach.

PEARSON